

AR56



Surrey Metro Savings

Winspear Business Reference Room
University of Alberta
1-18 Business Building
Edmonton, Alberta T6G 2R6

**committed to
service
excellence**

98
annual
report



ABOUT THE COMPANY

Surrey Metro Savings was incorporated in 1947 and has grown to become Canada's second largest Credit Union, with more than \$2.0 billion in assets. The Company provides a full range of retail banking services. It also operates a Commercial Lending Unit. Surrey Metro Savings provides its services through 17 retail branches and a centralized telephone call centre serving the communities of Surrey, Langley, Fort Langley, White Rock, Delta, Abbotsford, and Chilliwack. These communities comprise the Fraser Valley region, with a population of approximately 700,000. Historically the trading area has been one of the fastest growing regions in Canada.

The Company also owns Metro Insurance Services Ltd., which operates five insurance offices, and Shoreline Projects Ltd., a property development subsidiary. Surrey Metro Savings is incorporated under the Credit Union Incorporation Act of British Columbia and also operates under the regulations of the Financial Institutions Act of British Columbia. At Surrey Metro Savings, depositors are protected up to \$100,000 by the Credit Union Deposit Insurance Corporation of British Columbia. The Company's Non-Voting Shares are listed on The Toronto Stock Exchange under the symbol SMS.

Merger

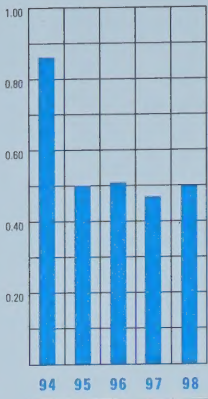
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- (a) each holder of Non-Voting Shares would receive \$24 per share in cash;
- (b) each member would receive the redemption value of \$1 per preferred share in cash;
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- (d) all employees received a compensation guarantee for a period of two years; and
- (e) there were no lay-offs of branch or Call Centre employees as a result of the merger.

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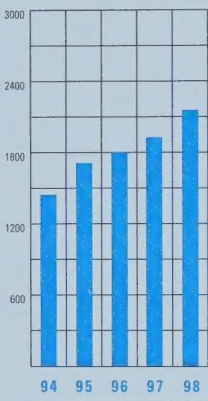
MetroDirect

In 1998 the Company launched its Internet Banking service MetroDirect, which provides customers with the convenience of banking from their home or office.



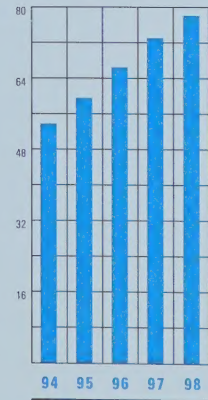
Return on Average Assets in percent

Increased earnings resulted in a higher ROAA at 0.50% versus 0.47% in 1997.



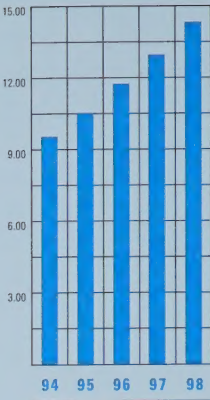
Assets in millions of dollars

Asset growth was 11.9% as compared to 6.7% in 1997.



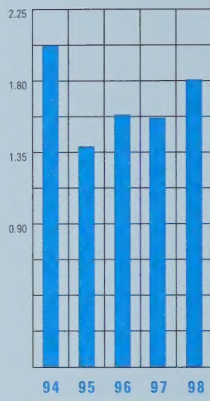
Non-Voting Shareholders' Equity in millions of dollars

Shareholders' equity grew by 6.8%.



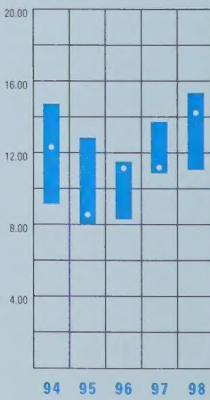
Book Value Per Non-Voting Share in dollars

Book value increased by \$1.41 as a direct result of earnings retained.



Earnings per Non-Voting Share

Net interest margins increased from 2.35% to 2.46%



Non-Voting Shares Trading Ranges in dollars

o close (Dec. 31)

FINANCIAL HIGHLIGHTS

	December 31	% Change	1998	1997
<i>in thousands of dollars</i> Balance Sheet				
Assets	11.9		2,158,710	1,929,377
Loans	8.1		1,803,044	1,668,350
Deposits	16.6		2,009,454	1,723,157
Shareholders' Equity	6.8		78,123	73,147
<i>in thousands of dollars</i> Results of Operations				
Net Interest Income	12.7		49,463	43,889
Other Income	8.1		16,295	15,068
Non-Interest Expenses	8.8		50,201	46,135
Net Income	13.9		10,105	8,875
Financial Statistics				
<i>in percent</i> Operating Efficiency			76.30	78.30
<i>in percent</i> Return on Average Equity			13.31	12.70
<i>in percent</i> Return on Average Assets			0.50	0.47
<i>in dollars</i> Earnings Per Share			1.81	1.57
<i>in dollars</i> Earnings Per Share Fully Diluted			1.74	1.53
<i>in thousands</i> Number of Non-Voting Shares Outstanding				
As at Basic			5,451	5,664
As at Fully Diluted			5,772	5,831
Average Basic			5,571	5,664
Average Fully Diluted			5,816	5,792
Dividends				
<i>in percent</i> Preferred Shares			6.66	4.90
<i>in dollars</i> Non-Voting Shares			0.40	0.40
<i>in dollars</i> Non-Voting Shares				
High			15.35	13.75
Low			11.05	10.90
Close (December 31)			14.25	11.10
Book Value			14.33	12.92

Surrey Metro Savings had an exciting and prosperous 1998. During the year the Company reached \$2 billion in assets, just seven years after crossing the \$1 billion mark. Earnings, return on assets and return on equity all showed an improvement over the preceding year. On February 10, 1999, Surrey Metro Savings signed a merger agreement with Canada Trust. At the March 17, 1999 meetings of members and Non-Voting shareholders which were held to consider the merger, the proposal carried the necessary two thirds vote from the Non-Voting shareholders but did not obtain the necessary two thirds vote from the membership. The merger proposal therefore did not obtain the necessary approval of the members.

Earnings

Surrey Metro Savings' net income for 1998 was \$10.1 million, an increase of 13.9% over the \$8.9 million achieved in 1997. Earnings per share were \$1.81, up from \$1.57 in 1997. Interest income, year-over-year, increased \$9.8 million, while interest expense increased \$4.3 million, resulting in an increase in net interest income of \$5.6 million. Expressed as a percentage of average assets, net interest income increased to 2.46% from 2.35% on a year-over-year basis. A significant factor in the improved net interest income was the maturity of several interest rate swaps. These swaps were not replaced due to the fact that the Company's interest rate risk was well within the policy guidelines set by the Board of Directors. Other income grew 8.1% in 1998 with non-interest expenses up 9%. As a result of fourth quarter deposit growth, Surrey Metro Savings was able to reduce its effective annual tax rate to 25% from the 40% it had accrued during the year. These savings were largely offset by an increase of \$1.1 million in the annual provisions for credit losses and accelerated depreciation of \$0.7 million on certain telephone and computer equipment. These provisions increased Surrey Metro Savings' total allowance for credit losses to \$4.6 million in 1998, or 0.26% of total loans, more in line with industry standards. This compares to total allowance for credit losses of \$3.2 million, as at December 31, 1997 representing 0.19% of total loans.

Balance Sheet

Total assets as at December 31, 1998 were \$2.2 billion, up 11.9% from \$1.9 billion in 1997. Loans increased by 8.1% to \$1.8 billion. Deposits grew by 16.6% to \$2.0 billion. Non-Voting shareholders' equity increased by 6.8% to \$78.1 million.

In February 1998, Surrey Metro Savings received approval to proceed with a normal course issuer bid through the facilities of The Toronto Stock Exchange. In 1998 the Company acquired 212,200 Non-Voting Shares at a cost of \$2.9 million or an average per share cost of \$13.72.

A detailed discussion of Surrey Metro Savings' financial results is included in the Management's Discussion and Analysis section.

Surrey Metro Savings had an exciting and prosperous 1998. During the year the Company reached \$2 billion in assets, just seven years after crossing the \$1 billion mark.

Operations

During the year the Company launched Metro Direct, our internet banking delivery channel. Metro Direct will allow customers the convenience of banking from their home or office or anywhere they might be with their laptop computer. We expect this channel of delivery to become what our call centre has become, the medium of choice for most people. Also during the year we expanded our call centre facility to accommodate a lending team, as well as staff from our insurance operation, Metro Insurance Services Ltd. Transaction volumes through the call centre are increasing each month. Our customers enjoy the convenience of banking over the telephone, either automatically or person to person.

The year 2000 project is on schedule. The mainframe banking system has been tested, simulating the January 1, 2000 date with no date-related issues. Contact with providers of external hardware, software and embedded systems has taken place, including services such as automated banking machines, Visa, data exchange suppliers and security systems.

Surrey Metro Savings expects to complete this initiative in mid-1999 within the original budget in the range of \$500,000 to \$1,000,000. The actual costs are either expensed as incurred or deferred and amortized pursuant to generally accepted accounting principles.

Merger Proposal

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At the Special General Meeting of members held on March 17, 1999, it was announced that only 24% of the 27,745 member votes cast endorsed the merger proposal. A total of 2,187,703 Non-Voting Shares were voted at the separate meeting of Non-Voting shareholders held on March 17, 1998, of which 86% voted in favor of the merger. The merger proposal required approval by two-thirds of the members and by two-thirds of the votes cast by Non-Voting shareholders.

Surrey Metro Savings has been advocating the consolidation of the credit union system for ten years, and has searched for a strategic partner during this period. We wish to remain highly competitive in a competitive market. We realize that a small player in the financial services sector will face increased competition as the federal government continues to make entry into this market easier. For this reason, we responded favorably to an approach made by Canada Trust. We need to grow because the financial services industry is oversupplied, profit margins are being squeezed, and the cost of technology continues to increase.

At the same time, our customers want the best of services and low service charges. To provide that, in this business, scale does matter. Larger institutions are able to afford and exploit technology better than smaller institutions, due to the fact that increased assets enable you to spread your fixed costs over a larger customer base.

We have spent \$18 million in the past five years on information technology in an effort to stay competitive. And we will continue to provide the technology and facilities that our customers demand, but it is extremely expensive and that is why we need to grow. We want to be the very best that we can be for our customers and we want to be able to provide a strong future for our employees.

With that in mind, Canada Trust seemed to be the perfect partner. They are focused on personal banking, the mainstay of our franchise. They believe, as we do, that the branch is the basic building block of the institution. Like us, they have a strong sales and service culture and they strive for service excellence. They have developed an aggressive growth strategy based upon opening new branches in Ontario, Alberta and British Columbia, and Surrey Metro Savings would have been the cornerstone of the British Columbia element of that strategy. We chose them because they are committed to being the best, they're not afraid of change, and they move quickly.

We believe that the proposed merger was in the best interest of every constituent. The shareholders would have received \$24 per Non-Voting Share, the employees received a generous employment pledge and the opportunity to broaden their careers and the customers would have enjoyed the benefits of a larger organization, while at the same time retaining the branches, staff and great personal service of Surrey Metro Savings. We believe that this was a very unique and strategically sound proposal for Surrey Metro Savings. However, the merger was rejected by our members because of their desire to bank with an institution that is locally controlled and their commitment to the credit union system. And we respect that.

Community Involvement

Surrey Metro Savings donated \$150,000 through its Community Involvement Fund to more than 69 organizations in 1998. The fund supports various charities, hospitals, sports teams, cultural societies and community service groups, as well as 30 scholarships for post-secondary education.

The Board and management have a fiduciary duty to represent all of the constituents of Surrey Metro Savings: members/customers, employees and our Non-Voting shareholders.

The Company also has a long history of supporting the United Way, having raised over \$331,000 over the past 5 years. In 1998, employees of Surrey Metro Savings contributed \$87,557, and with the corporate donation of \$20,000, we were delighted to present a cheque for \$107,557 to the United Way. The Company also won a United Way "Spirit Award" for its excellent employee campaign. Besides the Community Involvement Fund, the Company and its employees provide sponsorship of community events through various marketing and communication initiatives. These include the Run For Health and the Arts Club Theatre's Surrey Series.

Board of Directors

Our Directors continue to play a vital role in shaping policy and ensuring that we never lose sight of our customers, employees and shareholders.

In 1998, Dale Mumford stepped down from the nine member Board. After serving two terms of three years, Mr. Mumford decided not to run for a third term given the time commitments of his business. Elected to the Board last year was Tom Kirstein, a former three-term director and Chairman; re-elected were Bruce Chapman and Frank Harper. Mr. Chapman joined the Board in 1991 and is the Board's Senior Vice Chairman. Mr. Harper joined the Board in 1995 and is the Board's Vice Chairman. The Company is most fortunate to have attracted such a well-qualified and experienced group of men and women to serve the customers, employees and shareholders of the institution.

Looking Ahead

The Board and management have a challenging environment ahead. It is our objective to make Surrey Metro Savings more competitive for our customers and grow value for our shareholders. Strategic alliances will be explored with other organizations to enable us to accomplish some of the benefits which would have resulted from a successful merger.

The Board and management have a fiduciary duty to represent all of the constituents of Surrey Metro Savings: members/customers, employees and our Non-Voting shareholders. The Board and management will explore every possibility in order to create a larger, more competitive financial institution, all in the context of creating value for our shareholders.

Our customer service culture is second to none and we want to take this opportunity to acknowledge the fine efforts of our employees. With our highly motivated employees we are confident 1999 will be another successful year.



H.A. (Bert) Miles
Chairman of the Board



Lloyd M. Craig
President and Chief Executive Officer

Providing the highest level of customer satisfaction in the financial services industry is a concept that continues to define Surrey Metro Savings and its employees. Throughout the Company's 51-year history, friendly and professional customer service remains the key to success, especially with the development of alternative service-delivery channels. Excellent customer service involves much more than offering a friendly smile or recommending a particular investment product. It means taking the time to learn about a customer's needs, his/her lifestyle, and developing a trustworthy business relationship.

COMMITTED TO SERVICE EXCELLENCE

customer
satisfaction

The competitive nature of the financial services industry plays an ongoing role in shaping the Company. Determining our customers' desires and listening to their comments is an important part of Surrey Metro Savings' corporate philosophy. In order to succeed in our marketplace, we must remain tuned in to the needs of our customers. Focus groups, customer surveys, and customer-feedback programs all play a strong role in ensuring that the Company adapts to new challenges within the financial services industry. Our future is driven by our customers' needs.

Many customers still have a preference for conducting their banking transactions in person – they enjoy the familiarity and friendship offered by staff. Surrey Metro Savings recognizes that our branch network is an integral part of our business, as is our Call Centre. Regardless of where a transaction takes place, whether at a branch, over the telephone, or through a personal computer, customer service will always remain the most important aspect of our business. We are committed to serving customers at the highest level possible.

Ensuring that our branches provide the appropriate environment for customers to conduct their financial transactions is another key initiative in which we are working to enhance our quality of service. During 1998, we reconfigured the layout of several of our branches to include a number of private offices to address our customers' preference for a closed-door environment for various transactions. This initiative demonstrates the Company's responsiveness and sincere desire to satisfy our customers' needs.

Our employees are the Company's most valuable assets – We rely on their professional skill and ability to build long-term relationships with our customers. To retain our employees, we offer them many challenging and rewarding employment opportunities within the Company. To this end, Surrey Metro Savings has established a comprehensive list of training programs for staff to participate in.

Surrey Metro Savings' dedication to educating its staff and providing them with the necessary training and knowledge to help them excel at their jobs is twofold; it gives staff the confidence to accept additional challenges and ensures that we are offering customers the best service possible. Investing in our employees is one of our greatest achievements; it is the cornerstone of our success.

As we approach the next millennium, we will maintain our high level of customer service, our innovative spirit and our competitive nature to ensure continued success for Surrey Metro Savings.

The Year 2000 challenge deals with the possibility that computer systems may read the year "2000" as "1900." SMS began a project to deal with this issue in 1997 with an assessment phase to determine the size and complexity of the issue and to outline the financial and human resources necessary to address the issues and risks. The Year 2000 project team developed a strategy that encompasses hardware, in-house computer and embedded systems, vendors, customers and suppliers. Resource needs, time frames, testing and implementation requirements were identified to eliminate the potential Year 2000 impact on SMS.

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year 2000
project

The project is on schedule, with completion of all in-house systems expected by mid-1999. Testing of the Company's internal hardware, software and network architecture is currently under way. The mainframe banking system has been tested, simulating the January 1, 2000 date, with no date-related problems. Contact with providers of external hardware, software and embedded systems has taken place, including services such as Automated Banking Machines, credit cards, data exchange suppliers and security systems. There has also been an extensive review of corporate contracts, maintenance agreements and insurance policies.

SMS recognizes that it cannot guarantee that every aspect affecting the Year 2000 issue will be fully resolved. Specifically, the efforts of its business partners, suppliers and third-party providers to remedy their

own Year 2000 issues are beyond the Company's control. Contingency plans are being developed as part of the Year 2000 project to mitigate risk associated with reliance on external vendors, data exchange and contractual agreements. Assessment of the compliance efforts of those associated with SMS and the preparation of contingency arrangements where considered necessary is ongoing.

SMS expects to complete this initiative within its original budget in the range of \$500,000 to \$1,000,000 in mid-1999. The actual costs are either expensed as incurred or deferred and amortized pursuant to generally accepted accounting principles.



Surrey Metro Savings has always been aware of the need to provide convenient customer access to financial services and insurance products. To remain competitive in today's financial services industry, we must effectively meet all of our customers' needs.

There are two very distinct groups within our customer base; some prefer to use the branch network, while others choose to conduct transactions through "self service" channels, such as ABMs, telephones, or personal computers. In 1998, 85% of all banking transactions were processed electronically, supporting our focus on providing fast and convenient access to customers through alternative delivery channels.

alternative
COMMITTED TO SERVICE EXCELLENCE
delivery channels

During the past 15 years, we added a number of services to enhance customer convenience. In 1983, we added ABMs to our branch network to allow 24-hour banking; in 1989, we introduced Touch Tone Teller, our automated telephone banking service which offered customers access to their accounts from the convenience of their homes; in 1989, we issued debit cards; in 1995, we opened our state-of-the-art Call Centre, and in 1996, we established a web site on the Internet.

In 1998, Surrey Metro Savings took convenience to a higher level with the launch of Internet banking, and added a full range of lending and insurance products to the Call Centre.

Our web site, www.metroavings.com, provides easy access to information about Surrey Metro Savings. Information on products and services, interest rates, investor relations, and employment opportunities, is updated regularly. More than 31,000 people visited our web site last year to learn about our company.

MetroDirect, our Internet banking service, was launched in October 1998. Using a personal computer, customers now have 24-hour access to their bank accounts in a visual format. Routine transactions such as balance inquiries, transfers between accounts, and bill payments can be processed with a mouse and keyboard.

Early research indicated that 25% of our customers have personal computers and would use Internet banking. Approximately 18,000 people used MetroDirect during the last two months of 1998.

Offering customers better ways to manage their financial situation is an important objective for Surrey Metro Savings. In 1999, we will offer customers the ability to download their account information into Personal Financial Management software, such as Microsoft Money and Intuit Quicken, for further analysis, enabling greater money management for customers.

The Call Centre continues to provide valuable service to customers. In 1998, the office was expanded to accommodate a full range of loan, mortgage, and insurance products. Fully qualified loan and insurance staff are available to handle new business and customer inquiries Monday through Saturday, 8 a.m. to 8 p.m.

Surrey Metro Savings is committed to offering customers alternative delivery channels to suit their banking preference. To maintain our competitive edge in the financial services industry, we will continue to develop products and services to meet all our customers' needs.

More and more financial institutions are offering customers options in wealth management, a process that can be defined as "guiding individuals through their entire financial life cycle by offering diverse ranges of financial products and services." It is evolved from a term that previously referred to only savings investments, to an expression which integrates various services such as investment advice, financial planning, tax advice, asset accumulation, and will and estate planning.

COMMITTED TO SERVICE EXCELLENCE

wealth
management

As the population continues to age, and a larger segment approaches their retirement years, customers expect their financial institution to provide expert and professional investment advice. Surrey Metro Savings must also look to the future with our customers and provide the very services that our customers demand.

Today's customers are growing in sophistication – they want the greatest return possible on their investments and also are looking for choices on how to best manage their money. Surrey Metro Savings' wealth management program was designed to take a look at our customers' entire financial portfolios and help them accumulate and manage their assets so that they are financially prepared for their retirement years.

Our expert financial planners and insurance consultants can offer a wide range of mutual fund products, including ethical funds and third-party funds. We have also added segregated funds, which are growing in popularity as they offer the potential for increased returns while at the same time providing capital guarantees.

In many of our branches, we have Personal Financial Managers (PFMs) who also look after our customers' investment needs. The role of these managers is to establish and maintain an ongoing relationship with our top retail customers at the branch level. These customers appreciate the importance of staff continuity in dealing with their financial needs.

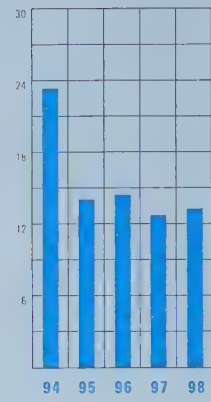
Competition in the wealth management business will continue to grow, as evidenced by the number of banks, insurance companies, mutual fund dealers, accountants, and estate lawyers willing to offer these services. Our main advantage is that we have already established an excellent financial relationship with our customers and they have grown to trust the friendly and professional advice they receive from Surrey Metro Savings staff.

Our reputation as a responsive and flexible company was founded on customer service. We will always look at ways to grow with our customers and provide them with the financial products and services to meet their needs. Our commitment to offering wealth management services demonstrates our goal of providing customers with a wide variety of financial products and services to keep them as satisfied customers for life.

wealth
management

PERFORMANCE AGAINST OBJECTIVES

	Objectives	Performance
Deposit Growth	Increase deposits by \$103 million.	\$286 million
Loan Growth	Increase total loan portfolio by \$142 million.	\$135 million
Capital	Attain BIS capital level of 10.0% of risk-weighted assets.	9.91%
Profitability	Achieve \$9.6 million net income after tax.	\$10.1 million
Return on Average Assets	Achieve an after-tax return of 0.49% on average assets.	0.50%
Return on Average Equity	Achieve return on average equity of 12.42%.	13.31%
Non-Interest Expenses	Total non-interest expenses (including subsidiaries) to be no greater than 2.41% of average assets.	2.50%
Earnings Per Non-Voting Share	Achieve earnings per share of \$1.69.	\$1.81



Return on
Average Equity
in percent

ROAE increased as a
result of improved
earnings.

This section of the Annual Report contains details of the operations and financial condition of Surrey Metro Savings (SMS). It also provides a discussion of how the Company manages credit, liquidity, and interest rate risks, as well as information on its capital structure.

Introduction

SMS successfully competes with banks, trust companies, credit unions, and other financial institutions in its market area by providing a high level of service and product quality. Its business focus is on attracting retail savings deposits from customers in the Fraser Valley region of British Columbia and using this deposit base to fund a loan portfolio comprised primarily of residential first mortgage loans.

The Fraser Valley region is one of the fastest growing areas in Canada and SMS is a well-established financial institution with a 51-year history of serving this region. The population growth in the Fraser Valley and SMS’s ability to compete successfully with other financial institutions have enabled SMS to achieve asset growth and earnings without deviating from its conservative strategy of funding residential first mortgage loans primarily with retail deposits.

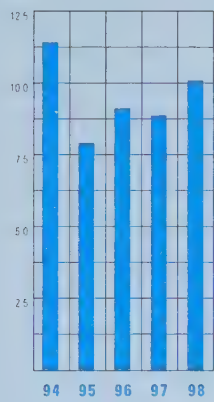
Overview of 1998

Net income for 1998 was \$10.1 million, up 13.9% from \$8.9 million achieved in 1997. Earnings per share for 1998 were \$1.81, compared with \$1.57 in 1997. Return on average assets was 0.50%, compared to 0.47% in 1997. Return on average equity was 13.31%, compared with 12.70% for 1997.

The number of Membership Shares (with a \$1 par value, and required by statute for membership) was 8,270,526 as at December 31, 1998. As prescribed by the Canadian Institute of Chartered Accountants, these Membership Shares are classified as liabilities. However, these shares are a part of SMS’s capital calculations, as permitted by the Superintendent. The number of Non-Voting Shares outstanding as at December 31, 1998 was 5,451,472. This number decreased from the previous year as a result of SMS buying back 212,200 Non-Voting Shares through a normal course issuer bid. These shares were acquired during the period from March 5, 1998 to October 22, 1998 at an average cost of \$13.72 per share.

Assets grew in 1998 by 11.9%, compared with 6.7% for 1997. The higher rate of asset growth was largely brought about by low interest rates. Total assets at year-end were \$2.2 billion, up from \$1.9 billion in 1997. Total loans were \$1.8 billion, up 8.1% from \$1.7 billion in 1997. Total deposits were \$2.0 billion, an increase of 16.6% from \$1.7 billion in 1997. Net interest income was \$49.5 million, up from \$43.9 million in 1997. Of this amount a portion was the result of SMS not having to renew maturing interest rate swaps in 1998 for purposes of interest rate risk management.

Other income was \$16.3 million versus \$15.1 million for the previous year. Non-interest expenses increased to \$50.2 million from \$46.1 million for 1997.



Net Income
in millions of dollars

Improved interest spread and competitive rates resulted in increased earnings.

Net Interest Income

Interest income is the major source of revenue for SMS. In 1998, SMS earned interest income of \$136.8 million from borrowers on their loans and from cash resources and investments. This represents an increase of \$9.8 million over 1997. Interest expense, which represents amounts paid by SMS on customer deposits and corporate borrowings, totalled \$87.3 million, an increase of \$4.3 million over 1997. Both increases reflect the general growth of SMS's loan and deposit portfolios over 1997.

Net interest income represents the difference between interest income and interest expense. Net interest income for 1998 was \$49.5 million, compared with \$43.9 million for 1997. Net interest income was positively impacted by the reduced level of interest rate swaps as well as a flattening yield curve. Included in 1997's net interest income was a \$0.75 million gain achieved through the sale of bonds. There was no bond activity in 1998. Net interest income, as a percentage of average assets was 2.46% for 1998, compared with 2.35% for 1997.

Analysis of Net Interest Income

in thousands of dollars	1998				1997			
	Average Balance	Mix (%)	Interest	Interest Rate	Average Balance	Mix (%)	Interest	Interest Rate
Cash resources and securities	237,709	12	9,477	3.99	212,802	11	9,370	4.40
Loans								
Residential	1,311,726	65	92,114	7.02	1,246,952	67	90,241	7.24
Commercial	243,042	12	18,520	7.62	198,916	11	14,674	7.38
Personal	69,628	4	6,384	9.17	69,861	4	5,344	7.65
Lines of Credit	118,978	6	10,312	8.67	104,581	5	7,344	7.02
Total loans	1,743,374	87	127,330	7.30	1,620,310	87	117,603	7.26
Other	29,627	1	—	—	37,014	2	—	—
Total	2,010,710	100	136,807	6.80	1,870,126	100	126,973	6.79
Deposits								
Demand	280,442	14	4,490	1.60	313,793	17	2,637	0.84
Term	946,556	47	46,019	4.86	780,563	42	42,577	5.45
RRSP	516,547	26	25,730	4.98	517,392	27	28,719	5.55
Total deposits	1,743,545	87	76,239	4.37	1,611,748	86	73,933	4.59
Borrowings	140,200	7	10,198	7.27	153,497	8	8,245	5.37
Subordinated notes	10,000	—	907	8.98	10,000	1	906	8.98
Other	41,031	2	—	—	25,012	1	—	—
Shareholders' equity	75,934	4	—	—	69,869	4	—	—
Total	2,010,710	100	87,344	4.34	1,870,126	100	83,084	4.44
Net interest income			49,463	2.46			43,889	2.35

Other Income

Other income is all income that is not interest related. This includes items such as service charges for retail banking services, lending fees, insurance commissions generated by SMS’s insurance company, rental income from SMS-owned properties, creditor insurance commissions, foreign exchange income, Visa fees and mutual fund commissions. SMS practices a “user pay” policy as much as possible, especially in relation to its deposit accounts and financial services, and reviews its lending fees and service charges annually to ensure adequate returns while maintaining market competitiveness. During 1998, SMS made minor changes to its service charges. Other income grew by 8.1% during 1998 to \$16.3 million, compared to \$15.1 million in 1997.

Non-Interest Expenses

Non-interest expenses represent all costs that are not interest related, excluding provisions for credit losses and income taxes. It includes staff salaries and benefits, occupancy, data processing, marketing, deposit insurance assessments, CUCBC dues, and provincial capital taxes. Total non-interest expenses for 1998 were \$50.2 million, a \$4.1 million or 8.8% increase over 1997. Non-interest expenses represented 2.50% of average assets, compared with 2.47% of average assets in 1997. In 1998, SMS accelerated depreciation by \$0.7 million on certain telephone equipment and computer equipment.

Staffing costs grew by \$1.7 million or 7.2%. The increase included sales incentives and individual team and corporate bonuses. The incentives program is reviewed by the Board of Directors on a regular basis and can be revised to reflect prevailing economic conditions.

Occupancy costs increased by \$0.7 million or 12.0% over 1997. General expenses increased by \$1.6 million, a 9.9% increase over 1997. Both these increases reflect nothing unusual, only the general increase in assets of SMS over 1997.

Capital Expenditures / Premises and Equipment

In 1998, SMS undertook normal capital expenditures as a result of routine capital replacements.

years ended Dec 31	1998	1997
in thousands of dollars ¹		
Building renovations and improvements	387	563
Leasehold improvements	461	549
Computer equipment/software	1,356	2,689
Furniture and equipment	986	1,057
Total	3,190	4,858

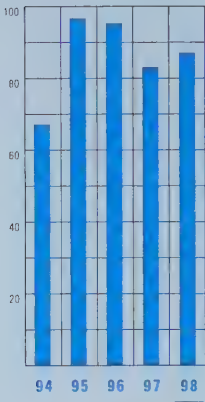
¹Does not include asset disposals.

Risk Management

Risk management is an ongoing and continuous process, with the goal of achieving consistent optimal earnings over the long term. All of SMS’s investment and loan policies, including risk management, are reviewed annually by the Board of Directors, and the Superintendent of Financial Institutions of British Columbia (Superintendent) reviews any changes to previously approved policies for prudence. The Board of Directors also reviews monthly reports on liquidity, interest rate risk, credit loss provisions, delinquent and impaired loans, regulatory capital and financial performance. There are three principal areas of risk which SMS monitors and manages: interest rate risk, credit risk and liquidity/investment risk.

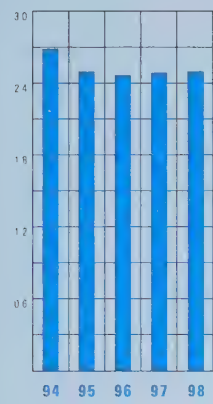
Interest Rate Risk/Matching Assets and Liabilities

Interest rate risk represents the effect movements in interest rates can have on SMS’s financial position. Interest rate risk arises when there is a difference in the amount of assets and liabilities that mature within a similar period.



Interest Expense
in millions of dollars

Increased deposit costs reflected the growth in deposits.



Non-Interest Expenses to Average Asset Ratio expressed as a percentage

Non-Interest expense as a percentage of average assets increased from 2.47% to 2.50%.

While the high proportion of residential first-mortgages provides a stable asset base, like any other financial institution, SMS’s annual profitability depends to a considerable extent on its ability to manage the maturities and yields of its assets against the maturities and costs of its liabilities.

SMS closely manages its interest rate risk through various strategies designed to optimize the return to SMS of differences between deposit and loan rates for different maturities. An asset and liability management committee comprised of the Chief Executive Officer, senior vice presidents, vice presidents and other senior managers, meets monthly to review and monitor asset and liability-related activities and initiate policy changes where necessary. A subcommittee of this group meets weekly.

The differentials shown in the table below for different maturities can change from one year to the next and to some extent are dependent on the

interest rate expectations held by the mortgage, loan and deposit customers of SMS. As previously noted, this information is monitored by management on a weekly basis to ensure early identification of any trends that are developing, or any differentials that are becoming materially large. Through computer modelling techniques, SMS determines its interest rate risk on a monthly basis. The modelling determines the effect that rising or falling interest rates would have on pretax income and market value over the next 12 months. If the interest rate risk is approaching a level above policy guidelines, the largest differentials are reduced through either conventional means, such as deposit drives and the sale of mortgages or through employing derivative instruments such as interest rate swaps.

The following table shows the matching of maturities of the assets and liabilities of SMS at December 31, 1998, as well as those at December 31, 1997.

Asset and Liability Maturities

as at December 31	1998			1997		
	Assets	Liabilities	Differential	Assets	Liabilities	Differential
in thousands of dollars						
Interest sensitive						
Maturing within 1 year	889,484	1,384,696 ¹	495,212	804,984	1,115,735 ³	310,751
Maturing between						
1-2 years	371,582	195,444 ²	(176,138)	198,202	173,213	(24,989)
2-3 years	235,364	197,793 ²	(37,571)	409,331	164,694 ¹	(244,637)
3-4 years	282,498	137,378	(145,120)	203,127	170,171 ¹	(32,956)
4-5 years	303,392	109,201	(194,191)	258,129	179,938	(78,191)
6-10 years	29,279	10,000	(19,279)	13,470	10,000	(3,470)
Non-Interest bearing items ⁽⁴⁾	47,111	124,198	77,087	42,134	115,626	73,492
	2,158,710	2,158,710	—	1,929,377	1,929,377	—

¹ Includes the effect of \$40,000,000 in interest rate swaps.

² Includes the effect of \$20,000,000 in interest rate swaps.

³ Includes the effect of \$80,000,000 in interest rate swaps.

⁴ Assets include cash, accrued interest receivable, premises and equipment and other items. Liabilities include accrued interest payable and other items.

Rapidly rising interest rates can negatively impact SMS’s net interest income, as a large portion of SMS’s liabilities will reprice before many of its assets can do the same. Most financial institutions tend to deem a prudent level of asset/liability mismatching to be necessary in order to improve profitability. The challenge is to find the level of mismatch that will optimize a financial institution’s net interest income without unduly increasing risk in the event of rapid changes in interest rates.

Credit Risk

SMS’s system for controlling the risk of borrowers defaulting on loan obligations is based upon strict adherence to clearly defined credit policies and credit approval procedures. Authority for loan approval to specified limits is granted to officers within each branch by the President and Chief Executive Officer within the guidelines reviewed annually by the Board of Directors. Loan approval limits are established based upon the experience and qualifications of the individuals involved. If a proposed loan is beyond the lending limit prescribed for branch management, it is forwarded, to the manager, retail credit, or the vice president, credit, depending on the size of the loan. If a loan is

beyond the internal lending limit prescribed for the vice president, credit, it is submitted to the loans committee (comprised of senior lending managers) and either approved at this level, or further recommended for approval to the management credit committee (comprised of the Chief Executive Officer and other executive officers).

All new lending in each branch is reviewed at least annually by a credit inspector to ensure adherence to policy guidelines and general credit quality. Loans requiring collection are removed from the branch level and centralised for further follow-up in the Retail Credit Department.

Liquidity / Investment Risk

As required by the Financial Institutions Act (FIA), 10% of SMS's total deposits and borrowings are held at Credit Union Central of British Columbia (CUCBC) in a liquidity portfolio comprised of deposits with maturities ranging from overnight to one year. The CUCBC deposits provide yields similar to those of Government of Canada Treasury Bills. In addition to the liquidity portfolio held at CUCBC, SMS maintains excess liquidity. SMS's goal is to maintain a total liquidity portfolio of 10.5% to 12.5% of total deposits and borrowings. It is management's view that a total liquidity portfolio between 0.5% and 2.5% in excess of that required by the FIA provides a prudent margin of liquidity over the 10% statutory requirement without unduly impairing SMS's return on assets.

SMS's investment policy specifies the minimum rating, maximum term and certain single investment exposures for investments made with excess liquidity. In general, excess liquidity is invested in money market instruments that are rated R-1 low or higher and mature in less than one year. At December 31, 1998, SMS's liquidity was 15.1% of deposits and borrowings, as compared to 12.2% in 1997.

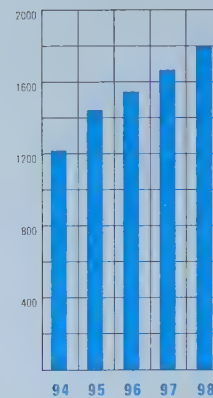
Loans

Total loans as at December 31, 1998 were \$1.8 billion, compared with \$1.7 billion at the previous year-end, an increase of 8.1%.

SMS aggressively competes for, and is a major holder of, residential first mortgages in the Fraser Valley region. It grants mortgages to individuals according to conventional mortgage-lending standards for residential properties. SMS offers closed fixed-rate mortgages, open variable-rate and fixed-rate mortgages, written with terms of 6 months to 10 years. At December 31, 1998, SMS's portfolio of residential first mortgage loans totalled \$1.4 billion, representing 75.2% of total loans outstanding, compared with total residential mortgage loans of \$1.3 billion, which represented 75.6% of the total loans at December 31, 1997. Net growth of mortgage loans over 1997 was 7.6%.

Although mortgage rates continued to remain low, the real estate market in the Fraser Valley region was relatively flat in 1998. According to Statistics Canada, the Fraser Valley still remains one of the fastest growing regions in Canada. Compared with other areas of British Columbia's Lower Mainland, such as Vancouver, Richmond, Burnaby and the North Shore, the Fraser Valley also continues to offer lower housing prices. Significant numbers of new residents continue to move into the Fraser Valley region. The board of governors of the Greater Vancouver Regional District expects the lower Fraser Valley region to record the highest rate of population growth in the Lower Mainland well into the next century. The availability of undeveloped land has kept average housing costs significantly lower than in other parts of the Lower Mainland, which results in average mortgages being substantially lower. Lower average mortgage advances may reduce the risk to SMS of individual defaults.

Personal loans to customers include instalment loans, demand loans and lines of credit. SMS also offers a Visa credit card through an arrangement with a major Canadian chartered bank. Under the arrangement, SMS does not carry the receivables owing from its credit card holders but earns a fee based on the total net purchases generated by its credit card holders, as well as a per card fee.



Total Loans

in millions of dollars

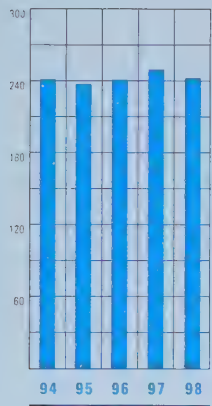
Loan growth was 8.1% in spite of a flat real estate market.

At December 31, 1998, SMS had a personal loan portfolio of \$177 million representing 9.8% of total loans outstanding, compared with \$172 million representing 10.3% of total loans at December 31, 1997.

Commercial lending consists primarily of first-mortgage loans to small and medium-sized businesses for real estate projects in the Lower Mainland region. The types of mortgages offered are similar to residential mortgages, except the maximum term is limited to five years. Although SMS also conducts other forms of commercial lending, these constitute a small portion of the commercial loan portfolio.

At December 31, 1998, SMS's commercial loan portfolio totalled \$270 million, representing 15.0% of total loans outstanding, compared with \$234 million, representing 14.1% at December 31, 1997. Net growth of commercial loans was 15.4%.

SMS maintains conservative lending policies. SMS holds no foreign loans. SMS's policy limits commercial lending to a maximum of 20% of SMS's total loans portfolio and the maximum loan exposure to any one borrower to an amount which is the lesser of \$8.5 million or 10% of SMS's aggregate share capital, retained earnings and subordinated notes. SMS has no loans outstanding that exceed its internal limit. This limit is included in SMS's internal investment and lending policy which is reviewed annually by the Superintendent.



Average Annual
Detached Residential
Prices
in thousands of dollars

Source: Fraser Valley
Real Estate Board

Loan Portfolio

as at December 31

			1998	
	Number	Total ¹ in millions of dollars	Percentage (%)	Average size in thousands of dollars
Individuals				
Mortgages				
Conventional	8,354	936	51.9	112
Revenue	652	74	4.1	113
Progressive	111	20	1.1	180
NHA/MICC Insured	1,598	227	12.6	142
SMS high-ratio	652	98	5.5	150
Subtotal mortgages	11,367	1,355	75.2	119
Other				
PLC ² (mortgage secured)	1,197	57	3.2	48
PLC ² (other)	18,217	57	3.2	3
Personal loans	10,137	63	3.4	6
Subtotal other	29,551	177	9.8	6
Subtotal individuals	40,918	1,532	85.0	37
Commercial				
	929	270	15.0	291
	—	1,802	100.0	—
Accrued interest	—	6	—	—
Total loan portfolio	41,847	1,808	—	43

¹ Before allowance for credit losses.

² Personal Line of Credit.

Asset Quality Coverage

SMS's asset quality coverage at the indicated dates was as follows:

as at December 31	1998	1997	1996	1995	1994
<i>in thousands of dollars</i>					
Total loans	1,803,044	1,668,350	1,548,486	1,444,649	1,221,162
Provision for credit losses ("PCL")	2,331	1,190	1,162	600	600
Loan write-offs	852	1,040	678	421	327
Total allowance	4,631	3,152	3,003	2,519	2,340
Impaired loans	4,124	3,845	5,003	4,090	617
Shareholders' equity	78,123	73,147	66,537	59,628	53,836
<i>in percent</i>					
PCL as % of total loans	0.13	0.07	0.08	0.04	0.05
Loan write-offs as % of total loans	0.05	0.06	0.04	0.03	0.03
Impaired as % of total loans	0.23	0.23	0.32	0.28	0.05
Impaired as % of shareholders' equity	5.28	5.26	7.52	6.86	1.15
Total allowance as % of impaired loans	112.29	81.98	60.02	61.60	379.30
Total allowance as % of total loans	0.26	0.19	0.19	0.17	0.19

Allowance for Credit Losses

SMS has an established policy of providing an allowance to cover potential credit losses. It is reviewed on an ongoing basis and if potential credit losses are identified, a specific allowance is established. In 1998, SMS increased the provision for credit losses by \$1.1 million for a total provision of \$2.3 million, as compared to \$1.2 million in 1997. This provision increased SMS's total allowance for credit losses to \$4.6 million or 0.26% of total outstanding loans, which is more in line with industry standards. As at December 31, 1997, the total allowance for credit losses was \$3.2 million, representing 0.19% of total loans. These allowances are after loan write-offs of \$0.85 million in 1998, compared to \$1.04 million in 1997.

Deposits

Total deposits as at December 31, 1998 were \$2.0 billion, compared with \$1.7 billion for the previous year, an increase of 16.6%. Deposit growth remained challenging throughout the year due to historically low interest rates.

SMS offers a full range of personal deposit services and products, including chequing accounts, savings accounts and term deposits. All deposit accounts are in Canadian funds, with the exception of a special United States dollar investment chequing account. SMS also provides special benefit packages on some of its accounts for individuals aged 59 and over or 18 and under. SMS is also active in the registered retirement savings plan (RRSP) market, offering term and variable RRSPs and registered retirement income funds (RRIFs).

At December 31, 1998, total demand deposits, including preferred shares, represented 13.9% of total deposits, compared with 16.3% in the previous year. Term deposits represented 59.4%, compared with 53.2% in 1997 and registered retirement savings plans represented 26.7%, compared with 30.5% in 1997.

SMS is an aggressive competitor for deposits in its market. The low interest rate environment in 1998 resulted in modest RRSP deposit growth as investors opted for mutual funds. SMS continues to develop innovative and competitive marketing strategies for this major deposit drive. In 1998, the registered savings plan portfolio increased by \$12.2 million, compared with a \$3.3 million increase in 1997.

Term deposits are the most suitable for matching with mortgage lending. SMS continued to be successful throughout 1998 in developing a term portfolio (including registered plans) which represented 86.1% of the total deposit base as at December 31, 1998, compared with 81.7% in 1997.

In 1998, with interest rates remaining at relatively low levels, deposit growth became a challenge as a result of strong competition from mutual funds, stocks and bonds and other equities. SMS introduced various flexible deposit products designed to appeal to retail and institutional customers.

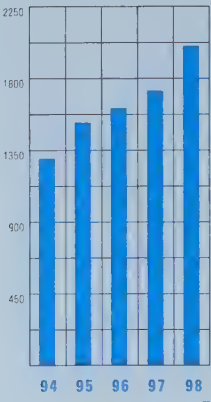
SMS also actively markets a family of eight ethical mutual funds owned and managed by the Canadian credit union system. These funds provide SMS customers with another investment option and provide SMS with an alternative source of revenue. SMS also sells a variety of third-party mutual funds, and receives the standard commissions for these sales.

Borrowings

In June 1994, SMS entered into an arrangement with several financial institutions for a \$70 million syndicated loan. This facility has been increased several times and now stands at \$115 million. As well, SMS established an additional facility with another financial institution in 1998 for \$65 million. Both loan facilities are subject to standby fees and may be drawn down at any time. In addition to these facilities, SMS maintains a substantial loan facility with CUCBC. Outstanding amounts under all three facilities fluctuated in the normal course of business during the past year. As at December 31, 1998, total outstanding amounts were \$50 million, down from \$110 million in 1997.

Capital

SMS's capital requirements are regulated by the Financial Institutions Commission (FICOM) using the risk-weighted approach developed by the Bank for International Settlements (BIS) in 1988. FICOM established a minimum capital standard based on a ratio of capital-to-risk weighted assets of 8%. At least 50% of a credit union's capital base, for the purpose of meeting



Total Deposits
in millions of dollars

Deposits grew by 16.6% in 1998 compared to 6.4% in 1997.

the standard, must consist of a core element known as Tier 1 capital, comprised of non-voting shares, preferred shares, contributed surplus, retained earnings and deferred income taxes. Secondary capital, known as Tier 2 capital, was reclassified in 1997 and now includes subordinated notes and a credit union's portion of retained earnings in the Credit Union Deposit Insurance Corporation (CUDIC), CUCBC and Stabilization Central Credit Union (Stabilization Central). A credit union's assets are weighted according to six categories of relative risk ranging from 0% to 150%. Residential mortgages, which form the majority of the assets of SMS, are risk-weighted at 50%.

As at December 31, 1998, SMS had a total capital ratio of 9.9%, down from the 10.4% in 1997.

The following tables show the levels of SMS's capital and its risk-weighted assets under the BIS requirements:

Risk-Weighted Assets

*in thousands of dollars unless otherwise stated
as at December 31*

	1998	1997		1998	1997
	Balance Sheet Amount	Balance Sheet Amount	BIS Risk Weight (%)	Risk-Weighted Balance	Risk-Weighted Balance
Cash resources	253,436	214,912	0	—	—
Commercial paper	64,291	8,372	0-100	22,537	4,186
Residential mortgages	1,089,075	1,033,391	50	544,538	516,696
NHA and MICC mortgages	227,407	206,491	0	—	—
High-ratio mortgages	98,297	71,881	100	98,297	71,881
Personal loans	121,151	121,010	0-80	85,987	85,426
Commercial loans	267,114	235,577	100	267,114	235,577
Revenue property	4,890	5,129	150	7,335	7,694
Other assets/investments	33,049	32,614	100	33,049	32,614
	2,158,710	1,929,377		1,058,857	954,074
<i>in percent</i>				1998	1997
Ratio of Capital to Risk-Weighted Assets:					
Tier 1 capital to risk-weighted assets				8.0	8.4
Tier 2 capital to risk-weighted assets				1.9	2.0
Total capital to risk-weighted assets				9.9	10.4

Tier 1 and 2 Capital

<i>as at December 31</i>	1998	1997
<i>in thousands of dollars</i>		
Tier 1 Capital		
Non-Voting Shares	27	28
Preferred Shares	8,271	7,795
Contributed surplus	248	248
Retained earnings ¹	79,104	74,124
Equity in subsidiaries	(1,256)	(1,253)
Deferred taxes	(2,139)	(984)
	84,255	79,958

Tier 2 Capital

Subordinated notes	10,000	10,000
Portion of equity in		
CUCBC, CUDIC and		
Stabilization Central ²	10,608	9,331
	20,608	19,331
Total Capital	104,863	99,289

¹ Presented on an unconsolidated basis as required under the capital requirements regulation of the FIA for calculating risk-weighted assets.

² Represents the 50% of the total amount of SMS's portion.

Year 2000 Project

The Year 2000 challenge deals with the possibility that computer systems may read the year "2000" as "1900." SMS began a project to deal with this issue in 1997 with an assessment phase to determine the size and complexity of the issue and to outline the financial and human resources necessary to address the issues and risks. The Year 2000 project team developed a strategy that encompasses hardware, in-house computer and embedded systems, vendors, customers and suppliers. Resource needs, time frames, testing and implementation requirements were identified to eliminate the potential Year 2000 impact on SMS.

The project is on schedule, with completion of all in-house systems expected by mid-1999. Testing of the Company's internal hardware, software and network architecture is currently

under way. The mainframe banking system has been tested, simulating the January 1, 2000 date, with no date-related problems. Contact with providers of external hardware, software and embedded systems has taken place, including services such as Automated Banking Machines, credit cards, data exchange suppliers and security systems. There has also been an extensive review of corporate contracts, maintenance agreements and insurance policies.

SMS recognises that it cannot guarantee that every aspect affecting the Year 2000 issue will be fully resolved. Specifically, the efforts of its business partners, suppliers and third-party providers to remedy their own Year 2000 issues are beyond the Company's control. Contingency plans are being developed as part of the Year 2000 project to mitigate risk associated with reliance on external vendors, data exchange and contractual agreements. Assessment of the compliance efforts of those associated with SMS and the preparation of contingency arrangements where considered necessary is ongoing.

SMS expects to complete this initiative within its original budget in the range of \$500,000 to \$1,000,000 in mid-1999. The actual costs are either expensed as incurred or deferred and amortized pursuant to generally accepted accounting principles.

Outlook

Loans and Deposits

Both loan and deposit growth will be a challenge in 1999. A sluggish British Columbia economy has more than offset the positive effects that the real estate market has had from some of the lowest mortgage rates experienced in the past 40 years. As such, management does not expect loan growth to substantially change from 1998.

Low interest rates will make deposit growth very challenging in 1999 as more customers and investors continue to look to higher yielding products such as mutual funds and equities. However, the market fluctuations from 1998 should have a positive impact on 1999 deposit drives. Investors, particularly those new to stock markets and mutual funds, are reconsidering their risk profiles and appear to be putting a higher portion of their investments back into guaranteed income instruments. Even so, SMS will continue

to aggressively pursue retail and institutional deposits in 1999.

Liquidity

SMS is targeting liquidity to remain in the range of 10.5% to 12.5% of deposits, plus borrowings. In management's opinion, this margin above the 10.0% statutory minimum, together with the ability of SMS to access its increased loan facilities and to sell mortgages, will provide adequate liquidity for normal operations.

Income

The flat yield curve presently prevailing in the Canadian money market would typically result in negative consequences for SMS's net interest income. This is because SMS tends to take on calculated levels of interest rate risk in order to widen average spreads and thus optimize profitability through funding long-term assets with short-term liabilities. With a flat yield curve, there is little income benefit from taking on additional interest rate risk. However, with risk-free matched spreads currently well over 2.0%, considerably higher than the historic range of 1.0 to 1.5%, SMS should be able to maintain net interest income levels throughout 1999 without having to rely on additional interest rate risk. Net interest income levels expected in 1999 assume relatively stable interest rates. However, if interest rates rise, net interest income is likely to be reduced slightly due to SMS's present modest interest rate risk exposure.

Provisions for credit losses in 1999 are expected to return to 1997 levels. Overall, non-interest expenses are expected to remain unchanged from 1998 levels.

Current income tax legislation provides that British Columbia corporations are taxed at rates that reach as high as 45.6%. Credit unions can reduce normal corporate income tax rates through a special income tax rate reduction that is based upon the relationship between the level of deposits and accumulated pre-tax earnings that were previously taxed at the reduced rates. Due to the fairly low deposit growth rate expected in 1999, SMS may not receive this tax rate reduction on portions of its 1999 taxable income and, accordingly, is increasing its expected provision for income taxes from 25% to approximately 40% for fiscal 1999. In the event

that deposit growth returns to historic levels, SMS will be able to reduce its income tax rate from the projected rate of 40%.

The anticipated interest rate environment, SMS's continued commitment to cost containment and the projected deposit growth should provide for an increase in net income in 1999.

Subsequent event

On February 10, 1999, SMS entered into a merger agreement (the "Merger Agreement") with CT Financial Services Inc. and Canada Trustco Mortgage Company ("CTMC" and, collectively with CT Financial Services Inc., "Canada Trust"). The transactions contemplated by the Merger Agreement are contingent upon approval by the members and non-voting shareholders of SMS.

The Merger Agreement provides for the merger of SMS with Canada Trust in a transaction under which:

- (a) each holder of non-voting shares will receive \$24 per share in cash;
- (b) each member other than CTMC and its affiliates will receive the redemption price for his or her preferred shares of \$1 each plus any declared and unpaid dividends;
- (c) all deposits of members will be transferred to CTMC and/or The Canada Trust Company; and
- (d) all remaining assets of SMS will be distributed to CTMC and CTMC will assume all of the remaining liabilities of SMS through the winding up of SMS.

Completion of the transactions contemplated by the Merger Agreement is contingent upon satisfaction of certain conditions contained in the Merger Agreement and the receipt of regulatory approvals.

The Merger Agreement also provides that if SMS delivers a written notice to Canada Trust which states SMS's intention to accept a superior proposal, then SMS will be required to pay to Canada Trust a fee of \$4 million unless the SMS members do not approve the transaction contemplated in such notice.

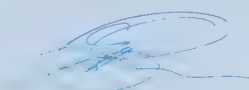
At the Special General Meeting of members held on March 17, 1999, it was announced that only 24% of the 27,745 member votes cast endorsed the merger proposal. A total of 2,187,703 Non-Voting Shares were voted at the separate meeting of Non-Voting shareholders held on March 17, 1998, of which 86% voted in favour of the merger. The merger proposal required approval by two-thirds of the members and by two-thirds of the votes cast by Non-Voting shareholders.

The consolidated financial statements and all other information contained in the Annual Report are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared by management in accordance with the requirements of the Credit Union Incorporation Act and appropriate generally accepted accounting principles in Canada, and include amounts based on informed judgements and estimates of the expected effects of current events and transactions. Financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

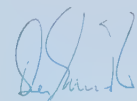
In meeting its responsibility for the reliability of financial data, management relies on comprehensive internal accounting, operating and system controls. Controls include an organizational structure providing for effective segregation of responsibilities, delegation of authority and personal accountability, and careful selection and training of personnel; the application of accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records, as well as a continued program of extensive internal audits.

These controls are designed to provide reasonable assurance that financial records are reliable for preparing financial statements and maintaining accountability for assets, and that assets are safeguarded against unauthorized use or disposition. The Board of Directors has appointed an Audit Committee, comprised of three Directors, to review with management and auditors the annual financial statements prior to submission to the Board of Directors for final approval.

Grant Thornton has been appointed by the membership as independent auditors to examine and report on the consolidated financial statements and their report appears below. They have had full and free access to the internal audit staff and the Audit Committee of the Board.



Lloyd M. Craig
President and Chief Executive Officer



Hermann G. Bessert
Senior Vice President, Finance

To the Shareholders of Surrey Metro Savings Credit Union

We have audited the consolidated balance sheets of Surrey Metro Savings Credit Union as at December 31, 1998 and 1997 and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the credit union's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made

by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the credit union as at December 31, 1998 and 1997 and the results of its operations and changes in its financial position for the years then ended in accordance with generally accepted accounting principles. As required by the Financial Institutions Act of British Columbia, we report that, in our opinion, these principles have been applied on a consistent basis.



Chartered Accountants
New Westminster, Canada

February 5, 1999, except as to Note 21 which is as of February 10, 1999.

CONSOLIDATED BALANCE SHEETS

December 31 / in thousands of dollars	Note	1998	1997
Assets			
Cash resources	2	317,727	223,284
Loans	3	1,803,044	1,668,350
Other	4	16,977	15,027
Premises and equipment	5	20,962	22,716
		2,158,710	1,929,377
Liabilities			
Deposits	6	2,009,454	1,723,157
Other	7	11,133	13,073
Borrowings	8	50,000	110,000
		2,070,587	1,846,230
Subordinated notes	9	10,000	10,000
Shareholders' Equity			
Share capital	10	275	276
Retained earnings	11	77,848	72,871
		78,123	73,147
		2,158,710	1,929,377
Commitments	16		
See accompanying notes to the consolidated financial statements.			

On behalf of the Board



Director



Director

CONSOLIDATED STATEMENTS OF INCOME

<i>years ended December 31</i>			
<i>in thousands of dollars, except per share amounts</i>	<i>Note</i>	1998	1997
Interest income	12		
Loans		127,330	117,603
Cash resources		9,005	6,622
Securities		—	2,474
Other		472	274
		136,807	126,973
Interest expense			
Deposits		76,239	73,932
Borrowings		11,105	9,152
		87,344	83,084
Net interest income		49,463	43,889
Provision for credit losses		2,151	984
		47,312	42,905
Other income	13	16,295	15,068
		63,607	57,973
Non-interest expenses			
Salaries and employee benefits		25,259	23,557
Occupancy		6,739	6,015
General	14	18,203	16,563
		50,201	46,135
Net income before income taxes		13,406	11,838
Provision for income taxes	15	3,301	2,963
Net income		10,105	8,875
<i>in thousands</i> Average number of non-voting shares		5,571	5,664
Earnings per non-voting share			
Basic		1.81	1.57
Fully diluted		1.74	1.53
<i>See accompanying notes to the consolidated financial statements.</i>			

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>years ended December 31 / in thousands of dollars</i>	1998	1997
Beginning of year	72,871	66,261
Net income	10,105	8,875
Repurchase of non-voting shares	(2,910)	—
Dividends on non-voting shares	(2,218)	(2,265)
End of year	77,848	72,871

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

<i>years ended December 31 / in thousands of dollars</i>	1998	1997
Cash resources provided by (used in)		
Operating activities		
Net income	10,105	8,875
Items not affecting cash resources:		
Amortization of premises and equipment	4,971	3,975
Amortization of goodwill	11	11
Deferred income taxes	(1,155)	(415)
Provision for credit losses	2,151	984
Changes in accrued interest receivable and payable	5,196	(4,991)
Changes in other non-cash operating items	(3,155)	2,643
	18,124	11,082
Financing activities		
Increase in deposits, net	280,761	108,865
(Decrease) increase in borrowings, net	(60,000)	10,000
Repurchase of non-voting shares	(2,911)	—
Cash dividends on non-voting shares	(2,218)	(2,265)
	215,632	116,600
Investing activities		
Increase in loans, net	(136,505)	(153,991)
Proceeds from sale of loans	—	33,165
Purchase of premises and equipment, net	(3,217)	(4,226)
Decrease in securities	—	27,217
Decrease in investments and other	409	692
	(139,313)	(97,143)
Increase in cash resources	94,443	30,539
Cash resources, beginning of year	223,284	192,745
Cash resources, end of year	317,727	223,284

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1998 and 1997
all tabular amounts are in thousands of dollars, except per share amounts

Governing legislation and operations

Surrey Metro Savings Credit Union (SMS) is incorporated under the Credit Union Incorporation Act of British Columbia; the operation of SMS is subject to the Financial Institutions Act of British Columbia. SMS serves members principally in the Fraser Valley region of British Columbia.

1. Significant accounting policies

These consolidated financial statements have been prepared in accordance with accounting practices generally accepted in Canada. In preparing these consolidated financial statements management has made estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates.

Basis of consolidation

The consolidated financial statements include the assets, liabilities and results of operations of SMS and its wholly owned subsidiaries, Metro Insurance Services Ltd. and Shoreline Projects Ltd.

Securities

Securities consisting of Investment Account Securities are purchased with the intention of holding to maturity. These debt securities are stated at cost. Premiums and discounts on the purchase of debt securities are amortized to interest income from securities using the yield method over the period to maturity of the related securities.

Loans

Loans are stated at the unpaid principal plus accrued interest less an allowance established to provide against probable losses on ultimate realization of the loan portfolio.

Loan interest

Interest income from loans is recorded by the accrual method, except for impaired loans classified as non-accrual. Interest income from loans classified as non-accrual is recorded on a cash basis into revenue when there exists no allowance for credit loss against the principal amount. In cases where an allowance for credit loss exists against the principal, and interest is recorded on a cash basis, amounts so received are used to reduce the principal.

Loan fees

Penalty income recorded on prepayment or renegotiation of fixed term loans is deferred and amortized to income over the average term of such loans.

Sale of loans

SMS, in the normal course of business, sells groups of loans. These sales transfer the significant risks and rewards of ownership and therefore meet accepted criteria for recognition as sales. Consequently, the assets from the sales are removed from the consolidated financial statements. Gains on such arrangements are recognized in the year of sale and are derived by capitalizing the net present value of the interest spread inherent in the pool. Revenue from service fees earned for administration of loans is recorded in other income.

Allowances for credit losses

SMS maintains specific allowances for credit losses that reduce the book value of loans identified as impaired to their estimated realizable amounts. An impaired loan is classified as non-accrual at the earlier of:

- in the opinion of management, there is reasonable doubt as to the collectibility of principal or interest
- interest is 90 days past due unless there is adequate security
- interest is 180 days past due.

Estimated realizable amounts are determined by discounting the expected future cash flows at the effective interest rate inherent in the loans, or by estimating the fair value of security underlying the loans and deducting costs of realization, or by estimating market prices for the loans.

SMS maintains a general allowance to absorb credit losses attributable to any deterioration of loan quality of the portfolio for which specific allowances cannot yet be determined. The general allowance is established based on payment arrears, known risks in the portfolio, historical credit loss experience and current economic conditions and trends.

Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further recovery is considered to be remote.

Investments

Investments are recorded at the lower of estimated net realizable value and cost.

Premises and equipment

Premises and equipment are recorded at cost less amortization which is provided using the straight line method over the estimated useful lives of the assets, as follows:

Buildings	40 to 50 years
Leasehold improvements	10 years
Computer and telephone equipment	3 years
Furniture and other equipment	5 to 10 years

Goodwill

Goodwill is recorded at cost less amortization which is provided using the straight line method over five years, except where a write-down is required to reflect permanent impairment.

Dividends

Dividends on preferred shares classified as deposit liabilities are charged to income for the year in respect of which they are calculated and are included in interest expense. Dividends on non-voting shares classified as equity are charged to retained earnings in the year that they are declared.

Deferred income taxes

SMS provides for income taxes using the tax allocation method whereby provisions for income taxes are recorded when the revenues or expenses giving rise to the taxes are recognized in the consolidated financial statements, rather than when such items are taxed. The amounts in respect of such timing differences are recorded as deferred income taxes.

Derivatives

SMS enters into interest rate swap agreements and other derivative financial instruments to manage its exposure to interest rate risk. Interest rate swaps are normally designated as hedges (reducing interest rate risk), and any gains or losses are recognized on the same basis as, and netted against, the interest income or expense related to the hedged item.

Assets under administration

SMS administers certain assets in the capacity of custodian for others and loans that have been securitized and sold. Assets under administration are not the property of SMS and are not reflected in the consolidated financial statements. Revenue from service fees earned for administration is recorded in other income.

Comparative figures

Certain comparative figures have been reclassified to conform with the current year's financial statement presentation.

2. Cash resources

	1998	1997
Cash on hand, deposits with banks and Credit Union Central of British Columbia, cheques and other items in transit	13,475	9,551
Demand and term deposits with Credit Union Central of British Columbia, due within one year	235,838	202,933
Bankers acceptances, commercial paper and other money market notes, due within one year	64,162	8,247
Accrued interest	4,252	2,553
	317,727	223,284

3. Loans

	Residential mortgages	Personal loans	Commercial mortgages and loans	Total
1998				
Loan principal	1,355,532	178,218	268,198	1,801,948
Accrued interest	3,683	290	1,754	5,727
Total loans	1,359,215	178,508	269,952	1,807,675
Allowance for credit losses	1,333	1,312	1,986	4,631
	1,357,882	177,196	267,966	1,803,044
Impaired loans	3,881	176	67	4,124
Less amounts where loss is not expected	3,427	29	—	3,456
Specific allowances	454	147	67	668
General allowances	879	1,165	1,919	3,963
	1,333	1,312	1,986	4,631
1997				
Loan principal	1,259,699	172,621	233,795	1,666,115
Accrued interest	3,538	276	1,573	5,387
Total loans	1,263,237	172,897	235,368	1,671,502
Allowance for credit losses	922	958	1,272	3,152
	1,262,315	171,939	234,096	1,668,350
Impaired loans	3,667	111	67	3,845
Less amounts where loss is not expected	3,464	—	—	3,464
Specific allowances	203	111	67	381
General allowances	719	847	1,205	2,771
	922	958	1,272	3,152
			1998	1997
Allowance for credit losses				
Balance, beginning of year			3,152	3,003
Provision, before recoveries of \$180 (1997 - \$206)			2,331	1,190
			5,483	4,193
Write-offs			(852)	(1,041)
Balance, end of year			4,631	3,152
Percentage of total loans			0.26	0.19
4. Other assets			1998	1997
Investments				
Shares, Credit Union Central of British Columbia			9,650	9,947
Other				
Accounts receivable			788	580
Deferred leasing costs			152	206
Prepaid expenses			4,124	3,063
Deferred income taxes			2,139	984
Other			124	247
			7,327	5,080
			16,977	15,027

5. Premises and equipment

	Cost	Accumulated Amortization	1998 Net Book Value	1997 Net Book Value
Land	3,402	—	3,402	3,402
Buildings	12,560	4,788	7,772	7,869
Leasehold improvements	5,996	2,633	3,363	3,344
Computer and telephone equipment	13,368	10,654	2,714	4,478
Furniture and other equipment	11,403	7,692	3,711	3,623
	46,729	25,767	20,962	22,716

6. Deposits

	1998	1997
Demand	270,384	272,718
Term	1,172,735	903,136
Registered savings plans	523,123	510,101
Preferred shares	8,270	7,796
Accrued interest	34,942	29,406
	2,009,454	1,723,157

Preferred shares included in deposits comprise an unlimited number of non-transferable, cumulative, redeemable shares with a par value of \$1 each, issued as a condition of membership to a maximum of 1,000 shares per member. Each share is entitled to a cumulative dividend at a floating rate equal to SMS's average daily prime rate of interest during the year and is redeemable at par value on withdrawal of membership.

7. Other liabilities

	1998	1997
Deferred mortgage prepayment penalties	3,547	4,025
Interest payable	1,378	2,610
Deferred rental income	744	724
Taxes payable	23	378
Other, including accounts payable and accruals	5,441	5,336
	11,133	13,073

8. Borrowings

Maturity date	Interest rate (%)	1998	1997
Credit Union Central of British Columbia			
October 20, 1998	5.50	—	5,000
August 20, 1999	6.92	10,000	10,000
October 20, 1999	5.80	5,000	—
August 30, 2000	7.25	10,000	10,000
September 18, 2000	7.40	20,000	20,000
August 21, 2001	7.52	5,000	5,000
		50,000	50,000
Syndicated bank borrowings			
January 8, 1998	3.79	—	20,000
February 17, 1998	3.94	—	20,000
May 19, 1998	4.21	—	20,000
		—	60,000
		50,000	110,000

Credit facility
SMS has established a credit facility of \$50,000,000 (1997 - \$Nil) with a Canadian chartered bank and a credit limit of \$15,000,000 (1997 - \$Nil) for interest rate swaps. These credit facilities are secured by a first floating charge on certain residential mortgages ranking in priority to the security of Credit Union Central of British Columbia. The facilities must be repaid by June 30, 2003. As at December 31, 1998, borrowings under these facilities were \$Nil and a letter of credit in the amount of \$15,000,000 was outstanding.

Credit Union Central of British Columbia
The borrowings are secured by a demand debenture in the amount of \$57,000,000 in favour of Credit Union Central of British Columbia, which creates a floating charge on assets and undertakings of SMS, and an assignment of book debts. Interest is payable semi-annually.

8. Borrowings (continued)

Syndicated bank borrowings

Borrowings syndicated by four financial institutions, for up to \$115,000,000 (1997 - \$100,000,000), are secured by a \$230,000,000 floating charge and a security interest on assets and undertakings of SMS. The syndicated bank borrowings are subordinated in right of repayment of borrowings to a Canadian chartered bank and Credit Union Central of British Columbia up to \$300,000,000. Repayment of individual term loans provided under these borrowings is required by no later than July 2003. This maturity date may be extended by mutual agreement. Interest is payable every 30 days for term loans due within 6 months and not less than semi-annually for term loans of longer duration.

9. Subordinated notes

Unsecured notes in the amount of \$10,000,000 (1997 - \$10,000,000) bear interest at 8.98% per annum, are payable semi-annually and mature on October 4, 2006. These notes are redeemable after October 4, 2001 and are subordinated in right of repayment of borrowings to a Canadian chartered bank, Credit Union Central of British Columbia, syndicated bank borrowings, and deposits.

10. Share capital

Authorized:

Non-voting shares

An unlimited number of transferable non-voting shares with a par value of \$0.005 each, fully participating in earnings after payment of dividends on preferred shares included in deposit liabilities.

First preferred shares

An unlimited number of retractable first preferred shares without par value and without fixed dividend entitlements.

Issued and outstanding:

	1998		1997	
	Number of shares	Amount	Number of shares	Amount
Non-voting shares				
Beginning of year	5,663,672	276	5,663,672	276
Repurchased	(212,200)	(1)	—	—
End of year	5,451,472	275	5,663,672	276

First preferred shares

As at December 31, 1998, there were no first preferred shares issued and outstanding.

Stock options

Certain key employees have been granted options to purchase non-voting shares at prices based on the market price of the shares as determined on the date of the grant. The total stock options outstanding at December 31, 1998 are as follows:

Year granted	Price per share	Expiry date	Number of shares
1992	6.00	October 28, 2002	11,000
1993	9.88	November 3, 2003	11,000
1994	11.00	November 1, 2004	17,000
1995	8.50	October 30, 2005	32,000
1996	9.13	January 22, 2006	8,000
1996	11.40	October 28, 2006	44,000
1997	12.05	October 27, 2007	44,000
1998	15.25	May 19, 2003	90,000
1998	15.25	July 26, 2003	60,000
			317,000
Employee stock option plan			3,763
			320,763

11. Capital requirements

The Financial Institutions Act requires SMS to maintain a capital base which is adequate in relation to its level of business activities. The level of capital required is based on a prescribed percentage of the total value of its risk-weighted assets, each asset of SMS being assigned a risk factor based on the probability that a loss may be incurred on ultimate realization of that asset.

The Financial Institutions Act regulations prescribe that the minimum required capital base is 8% of the risk-weighted value of assets. At December 31, 1998, SMS had a capital base of 9.91% (1997 - 10.4%) of the total value of risk-weighted assets.

12. Interest income

Interest income from loans includes \$2,389,000 (1997 - \$1,997,000) of penalty income recorded for prepayment or renegotiation of fixed term loans.

Interest income from securities includes interest of \$Nil (1997 - \$1,720,000) and net realized gains of \$Nil (1997 - \$754,000).

13. Other income

	1998	1997
Account service fees	7,329	6,895
Commissions	5,469	4,960
Lending fees	2,340	1,992
Other	1,157	1,221
	16,295	15,068

14. General operating expenses

	1998	1997
Bonding and other insurance	369	440
Capital taxes	896	808
Chequing service charges	1,375	1,225
Data processing	4,548	3,967
Deposit insurance assessment	860	811
Dues, Credit Union Central of British Columbia	473	519
Marketing	2,582	2,311
Professional and other services	2,301	2,038
Stationery, telephone and postage	2,656	2,644
Sundry	2,143	1,800
	18,203	16,563

15. Income taxes

in percent	1998	1997
Reconciliation of income tax rate		
Combined federal and provincial income tax rate	45.6	45.6
Increase (decrease) resulting from:		
Adjustments for income eligible for reduced rate	(23.5)	(23.5)
Adjustments for income not eligible for reduced rate	—	0.6
Other, net	2.5	2.3
	24.6	25.0

The effective income tax rate is less than the basic Canadian corporation tax rate primarily as a result of an income tax rate reduction available to credit unions of up to 23.5%. Eligibility for this reduction is based upon the relationship between the level of deposits and accumulated pre-tax earnings that were previously taxed at the reduced rates.

16. Commitments

Lease commitments

SMS occupies branch premises under long term leases extending to 2005. Aggregate basic annual lease payments for each of the next five years are:

in dollars	
1999	1,696,000
2000	1,555,000
2001	1,342,000
2002	974,000
2003	938,000

Off-balance sheet commitments

In the normal course of business, SMS enters into various off-balance sheet commitments such as letters of credit and derivative contracts. The letters of credit and the notional principal amounts for derivative contracts reported below are not reflected in the consolidated balance sheets. Details of these are as follows:

Letters of credit

At December 31, 1998, SMS had outstanding letters of credit on behalf of customers in the amount of \$6,421,000 (1997 - \$11,899,000). These letters of credit were fully secured by monies on deposit.

Derivative contracts

Interest rate swaps

At December 31, 1998, SMS had outstanding interest rate swap contracts in the notional principal amount of \$40,000,000 (1997 - \$80,000,000) maturing at various times in part until 2001. Interest rate swaps are transactions in which two parties exchange interest flows on a specified notional principal amount for a pre-determined period based on agreed-upon fixed and floating rates. Principal amounts are not exchanged and are not indicative of a credit exposure.

Index-linked swaps

At December 31, 1998, SMS had outstanding index-linked swaps in the notional principal amount of \$14,000,000 (1997 - \$7,000,000). Index-linked swaps are transactions in which for a fee SMS can manage its exposure to changes in the value of index-linked deposit products. Principal amounts are not exchanged and are not indicative of a credit exposure.

17. Maturities

	Interest sensitive balances				Total
	Within 3 months	4 months to 1 year	Over 1 to 5 years	Not interest sensitive	
1998					
Assets					
Cash resources	187,008	112,992	—	17,727	317,727
Yield in percent	4.96	5.07	—	—	
Loans	381,118	198,716	1,222,115	1,095	1,803,044
Yield in percent	8.22	6.85	6.88	—	
Other	—	9,650	—	28,289	37,939
Yield in percent	—	4.84	—	—	
	568,126	321,358	1,222,115	47,111	2,158,710
Yield in percent	7.14	6.17	6.88	—	6.69
Liabilities and shareholders' equity					
Deposits	764,887	604,809	604,816	34,942	2,009,454
Yield in percent	3.68	5.10	5.60	—	
Borrowings and subordinated notes	—	15,000	45,000	—	60,000
Yield in percent	—	6.55	7.73	—	
Other	—	—	—	89,256	89,256
Yield in percent	—	—	—	—	
	764,887	619,809	649,816	124,198	2,158,710
Yield in percent	3.68	5.14	5.75	—	4.51
	(196,761)	(298,451)	572,299	(77,087)	—
Derivatives, net	—	40,000	(40,000)	—	—
Interest sensitivity position	(196,761)	(258,451)	532,299	(77,087)	—

Maturity dates substantially coincide with interest adjustment dates. Amounts with floating rates, or due on demand, are classified as maturing within three months, regardless of maturity. Amounts that are not interest sensitive are grouped together, regardless of maturity.

A significant amount of loans and deposits can be settled before maturity on payment of a penalty. No adjustment has been made for repayments that may occur prior to maturity.

	Interest sensitive balances				Total
	Within 3 months	4 months to 1 year	Over 1 to 5 years	Not interest sensitive	
1997					
Assets					
Cash resources	101,516	109,665	—	12,103	223,284
Yield in percent	4.00	4.15	—	—	
Loans	405,489	178,367	1,082,259	2,235	1,668,350
Yield in percent	7.39	6.67	7.18	—	
Other	—	9,947	—	27,796	37,743
Yield in percent	—	2.50	—	—	
	507,005	297,979	1,082,259	42,134	1,929,377
Yield in percent	6.71	5.60	7.18	—	6.66
Liabilities and shareholders' equity					
Deposits	628,474	422,261	643,016	29,406	1,723,157
Yield in percent	3.04	3.92	5.99	—	
Borrowings and subordinated notes	40,000	25,000	55,000	—	120,000
Yield in percent	4.51	4.99	7.58	—	
Other	—	—	—	86,220	86,220
Yield in percent	—	—	—	—	
	668,474	447,261	698,016	115,626	1,929,377
Yield in percent	3.13	3.98	6.11	—	4.22
	(161,469)	(149,282)	384,243	(73,492)	—
Derivatives, net	40,000	—	(40,000)	—	—
Interest sensitivity position	(121,469)	(149,282)	344,243	(73,492)	—

18. Fair values of financial instruments

Estimated fair values of SMS's financial instruments are set out below. No fair values have been determined for premises and equipment, goodwill or any other asset and liability that is not a financial instrument. The estimated fair values of cash resources, variable rate loans, other assets and liabilities are assumed to equal their book values. The fair values of fixed rate loans and deposits are determined by discounting the expected future cash flows at the estimated current market rates for loans and deposits with similar characteristics.

The difference between the book and fair values of SMS's loans, deposits and other financial instruments is due primarily to changes in interest rates. As SMS normally holds these instruments to maturity, the book values have not been adjusted to reflect the differences. Not all financial instruments are readily marketable. As a result, the estimates of fair value are subjective and should not be considered precise.

	1998			1997		
	Book Value	Fair Value	Difference	Book Value	Fair Value	Difference
Assets						
Cash resources	317,727	317,727	—	223,284	223,284	—
Loans	1,803,044	1,817,075	14,031	1,668,350	1,677,822	9,472
Other	10,438	10,438	—	10,527	10,527	—
Liabilities						
Deposits	2,009,454	2,015,301	5,847	1,723,157	1,729,137	5,980
Borrowings	50,000	51,126	1,126	110,000	110,358	358
Subordinated notes	10,000	10,043	43	10,000	10,329	329
Other	5,441	5,441	—	5,336	5,336	—
Derivatives						
Financial instruments	—	(1,024)	(1,024)	—	(2,508)	(2,508)

19. Other information

At December 31, 1998 outstanding loans to directors, officers and employees totalled \$37,409,000 (1997 - \$36,370,000), which included 332 mortgages totalling \$32,827,000 and 953 other loans totalling \$4,582,000.

During the year, directors, in their capacity as directors, received remuneration of \$99,500 (1997 - \$95,000).

20. Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the Year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect SMS's ability to conduct normal business operations. SMS has developed and is implementing a plan designed to identify and address the expected effects of the Year 2000 Issue on SMS. At December 31, 1998, identification and assessment of the Year 2000 readiness of third parties, such as customers, suppliers and others, is ongoing. SMS is carrying out ongoing activities to modify, retire or replace computer systems identified to date which are not Year 2000 ready. However, it is not possible to be certain that all aspects of the Year 2000 Issue affecting SMS, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

21. Subsequent event

On February 10, 1999, SMS entered into a merger agreement (the "Merger Agreement") with CT Financial Services Inc. and Canada Trustco Mortgage Company ("CTMC" and, collectively with CT Financial Services Inc., "Canada Trust"). The transactions contemplated by the Merger Agreement are contingent upon approval by the members and non-voting shareholders of SMS.

The Merger Agreement provides for the merger of SMS with Canada Trust in a transaction under which:

- (a) each holder of non-voting shares will receive \$24 per share in cash;
- (b) each member other than CTMC and its affiliates will receive the redemption price for his or her preferred shares of \$1 each plus any declared and unpaid dividends;
- (c) all deposits of members will be transferred to CTMC and/or The Canada Trust Company; and
- (d) all remaining assets of SMS will be distributed to CTMC and CTMC will assume all of the remaining liabilities of SMS through the winding up of SMS.

Completion of the transactions contemplated by the Merger Agreement is contingent upon satisfaction of certain conditions contained in the Merger Agreement and the receipt of regulatory approvals.

The Merger Agreement also provides that if SMS delivers a written notice to Canada Trust which states SMS's intention to accept a superior proposal, then SMS will be required to pay to Canada Trust a fee of \$4 million unless the SMS members do not approve the transaction contemplated in such notice.

SELECTED QUARTERLY CONSOLIDATED FINANCIAL DATA

<i>unaudited</i> <i>in thousands of dollars</i>	Dec 31/98	Dec 31/97	Sep 30/98	Sep 30/97	Jun 30/98	Jun 30/97	Mar 31/98	Mar 31/97
Balance Sheets								
Assets								
Cash Resources	317,727	223,284	212,101	183,686	191,159	182,871	194,806	177,852
Securities	—	—	—	19,304	—	24,274	—	27,246
Loans	1,803,044	1,668,350	1,786,624	1,662,528	1,752,493	1,624,522	1,716,275	1,598,720
Other	16,977	15,027	15,367	15,563	15,520	15,396	15,388	15,952
Premises and Equipment	20,962	22,716	22,053	21,998	21,681	21,757	21,998	21,964
	2,158,710	1,929,377	2,036,145	1,903,079	1,980,853	1,868,820	1,948,467	1,841,734
Liabilities								
Deposits	2,009,454	1,723,157	1,753,640	1,625,407	1,707,191	1,623,187	1,673,864	1,616,432
Other	11,133	13,073	10,558	9,646	11,637	16,298	9,184	9,002
Borrowings	50,000	110,000	185,000	186,000	176,000	150,000	180,000	138,000
	2,070,587	1,846,230	1,949,198	1,821,053	1,894,828	1,789,485	1,863,048	1,763,434
Subordinated Notes	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Shareholders' Equity								
Share Capital	275	276	275	276	275	276	276	276
Retained Earnings	77,848	72,871	76,672	71,750	75,750	69,059	75,143	68,024
	78,123	73,147	76,947	72,026	76,025	69,335	75,419	68,300
	2,158,710	1,929,377	2,036,145	1,903,079	1,980,853	1,868,820	1,948,467	1,841,734
Income Statements								
Interest Income	35,598	33,071	35,071	31,701	33,770	31,324	32,368	30,877
Interest Expense	23,429	20,806	22,424	20,864	21,197	20,702	20,294	20,712
Net Interest Income	12,169	12,265	12,647	10,837	12,573	10,622	12,074	10,165
Provision for Credit Losses	1,415	429	364	149	190	202	182	204
	10,754	11,836	12,283	10,688	12,383	10,420	11,892	9,961
Other Income	3,926	3,654	4,032	4,034	4,184	3,629	4,153	3,751
	14,680	15,490	16,315	14,722	16,567	14,049	16,045	13,712
Non-Interest Expenses	13,667	12,479	12,086	11,133	12,407	11,112	12,041	11,411
	1,013	3,011	4,229	3,589	4,160	2,937	4,004	2,301
Provision for Income Taxes	(1,665)¹	757	1,676	896 ²	1,676	772 ²	1,614	538 ²
Net Income	2,678	2,254	2,553	2,693	2,484	2,165	2,390	1,763
<i>in dollars</i> Earnings per Share								
Basic	\$0.49	\$0.40	\$0.46	\$0.48	\$0.44	\$0.38	\$0.42	\$0.31
Fully Diluted	\$0.47	\$0.39	\$0.44	\$0.47	\$0.42	\$0.37	\$0.41	\$0.30
Non-Voting Shares								
As at Basic	5,451	5,664	5,485	5,664	5,601	5,664	5,654	5,664
As at Fully Diluted	5,772	5,831	5,802	5,786	5,858	5,786	5,821	5,786
Average Basic	5,468	5,664	5,543	5,664	5,628	5,664	5,658	5,664
Average Fully Diluted	5,790	5,809	5,825	5,786	5,840	5,786	5,826	5,786

¹The fourth quarter income tax amount reflects the change from a 40% tax rate estimate in the first three quarters to an actual 24.6% for the year. Unlike 1997, the previous three quarters have not been restated.

²Restated from previously released quarterly reports to reflect a reduction from the then anticipated corporation tax rate of approximately 30% to the actual rate of 25% for the fiscal 1997.

NINE-YEAR OVERVIEW

as at Dec 31/ in thousands of dollars	1998	1997	1996	1995	1994	1993	1992	1991	1990
Balance Sheets									
Assets									
Cash Resources	317,727	223,284	192,745	173,392	149,428	149,692	161,400	143,682	173,184
Securities	—	—	27,217	57,178	44,873	—	—	—	—
Loans	1,803,044	1,668,350	1,548,486	1,444,649	1,221,162	1,056,657	964,559	841,739	697,570
Other	16,977	15,027	17,254	16,514	15,137	15,361	14,708	15,252	19,964
Premises and Equipment	20,962	22,716	22,465	22,794	18,471	15,412	14,499	13,867	12,591
	2,158,710	1,929,377	1,808,167	1,714,527	1,449,071	1,237,122	1,155,166	1,014,540	903,309
Liabilities									
Deposits									
Demand	278,667	280,529	311,254	281,187	274,229	289,041	323,102	335,981	342,185
Term	1,192,820	916,888	785,605	772,415	652,222	531,321	465,617	378,794	332,947
RRSP	537,967	525,740	522,402	469,592	371,643	313,653	268,781	230,723	199,046
	2,009,454	1,723,157	1,619,261	1,523,194	1,298,094	1,134,015	1,057,500	945,498	874,178
Other	11,133	13,073	12,369	8,705	10,141	10,439	13,127	9,750	4,197
Borrowings	50,000	110,000	100,000	123,000	84,000	45,000	45,000	30,000	3,250
	61,133	123,073	112,369	131,705	94,141	55,439	58,127	39,750	7,447
Subordinated Notes	10,000	10,000	10,000	—	3,000	3,000	3,000	3,000	3,000
Shareholders' Equity									
Share Capital	275	276	276	208	76	76	28	—	—
Retained Earnings	77,848	72,871	66,261	59,420	53,760	44,592	36,511	26,292	18,684
	78,123	73,147	66,537	59,628	53,836	44,668	36,539	26,292	18,684
	2,158,710	1,929,377	1,808,167	1,714,527	1,449,071	1,237,122	1,155,166	1,014,540	903,309
Income Statements									
Interest Income	136,807	126,973	138,562	134,507	106,397	100,150	102,672	104,696	103,855
Interest Expense	87,344	83,084	95,099	96,530	67,079	64,868	70,983	77,156	82,342
Net Interest Income	49,463	43,889	43,463	37,977	39,318	35,282	31,689	27,540	21,513
Provision for Credit Losses	2,151	984	1,031	466	491	492	527	495	559
	47,312	42,905	42,432	37,511	38,827	34,790	31,162	27,045	20,954
Other Income	16,295	15,068	13,235	11,975	11,591	10,598	10,017	8,692	8,572
	63,607	57,973	55,667	49,486	50,418	45,388	41,179	35,737	29,526
Non-Interest Expenses	50,201	46,135	43,584	39,059	35,353	32,583	30,537	25,886	22,140
Net Income Before Income Taxes	13,406	11,838	12,083	10,427	15,065	12,805	10,642	9,851	7,386
Income Taxes									
Current	3,301	3,378	3,143	2,050	3,328	3,334	3,425	2,628	1,726
Deferred	—	(415)	(165)	456	313	(302)	(1,080)	(385)	(181)
	3,301	2,963	2,978	2,506	3,641	3,032	2,345	2,243	1,545
Net Income	10,105	8,875	9,105	7,921	11,424	9,773	8,297	7,608	5,841
Financial Statistics									
in percent Asset Growth	11.90	6.70	5.50	18.30	17.10	7.09	13.86	12.31	9.21
in percent Loan Growth	8.10	7.70	7.20	18.30	15.60	9.54	14.59	20.67	13.35
in percent Deposit Growth	16.61	6.40	6.31	17.34	14.47	7.24	11.85	8.18	9.55
Percentage of Average Assets									
Net Interest Income	2.46	2.35	2.45	2.41	2.97	2.92	2.90	2.87	2.45
Other Income	0.81	0.81	0.74	0.76	0.88	0.89	0.92	0.91	0.99
Non-Interest Expenses	2.50	2.47	2.45	2.48	2.67	2.73	2.82	2.70	2.58
Percentage Return On									
Average Assets	0.50	0.47	0.51	0.50	0.86	0.81	0.76	0.79	0.68
Average NV Equity	13.31	12.70	14.42	14.02	23.26	24.19	25.83	33.46	35.91
in dollars Book Value Per NV Share	14.33	12.92	11.75	10.54	9.55	7.92	6.49	4.68	3.32
in dollars Earnings Per NV Share	1.81	1.57	1.61	1.40	2.03	1.73	1.47	1.35	1.04
in dollars Earnings Per NV Share Fully Diluted	1.74	1.53	1.59	1.39	2.02	1.72	1.47	1.35	1.04

The Board of Directors is central to an effective system of corporate governance. The Board has adopted policies and procedures essential to the effective and prudent operation of Surrey Metro Savings, in keeping with guidelines established by The Toronto Stock Exchange (TSE) Committee for good corporate governance.

Mandate and Responsibilities of the Board

The fundamental objective of the Board of Directors of Surrey Metro Savings is to create value for the members and shareholders, and to protect the value of the Company against erosion. The Board's duties and responsibilities are carried out in a manner consistent with this fundamental objective.

The principal duty and responsibility of the Board is to supervise the management of Surrey Metro Savings, with the day-to-day management of the business and affairs of the Company delegated by the Board to the CEO and other executive officers.

The Board's responsibilities include overseeing the conduct of the Company's business, providing leadership and direction to its management, and setting policies. Long-term goals and strategies for the Company are developed as part of the Board's annual strategic planning process. Through this process, the Board adopts the operating plan for the coming year, and monitors management's relative progress through a regular reporting and review process. The Board identifies the principal risks of the business, and monitors these through established systems, policies, procedures and control mechanisms. Through the CEO, the Board sets standards of conduct, including the general moral and ethical standards for the conduct of the business as a leading financial institution.

Composition of the Board

Our nine-member Board of Directors is elected by the members of Surrey Metro Savings, with one director being related. Lloyd Craig, in addition to serving as a director, is the Company's President and Chief Executive Officer. Mr. Craig is not eligible to serve as Chairman of the Board. The eight unrelated directors are independent of management and are free from any interest, business or other relationships that could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of the Company.

Board Meetings and Procedures

There are six regularly scheduled meetings of the Board of Directors held each year. In addition, a Board/Management planning session is held to discuss strategic issues. Special meetings of the Board are held as required. Each committee of the Board meets as required to carry out its mandate as described in its terms of reference.

Prior to each Board meeting, the directors receive a comprehensive information package including the agenda, minutes of the previous Board and committee meetings, and material relating to items on the agenda. The Board utilizes a consent agenda process for routine matters in order to free up the Board's time for matters of strategic importance.

The Board has adopted a policy that enables the Board of Directors, Board committees, or an individual director, to engage an outside advisor at the expense of Surrey Metro Savings with the authority of the Governance Committee or the Board of Directors.

Committees of the Board

The Board has six standing committees: Executive, Audit, Human Resources, Conduct Review, Governance, and Investment and Loan. Each committee is comprised of three directors, and the Chair and CEO serve ex-officio on those committees to which they have not otherwise been elected or appointed. Each committee also has available to it as resource such members of management as may from time to time be determined to be appropriate. The Board determines the powers and responsibilities of each committee, and reviews the authority and mandate of each committee annually. The Chair of each Board committee reports to the full Board after each committee meeting.

The *Executive Committee* acts as a sounding board for the CEO on matters requiring Board involvement. This committee also acts in emergency circumstances as required between meetings of the full Board of Directors, and is responsible for representing the Company in certain financial services industry and public relations matters.

The *Audit Committee* assesses, influences, and helps set the tone for quality financial reporting and sound internal controls. The committee reviews the financial statements and recommends their approval to the Board. It also assesses the accounting principles and underlying risks, and assesses the adequacy and effectiveness of internal controls.

The *Human Resources Committee* reviews and assesses the CEO's achievement of corporate objectives, and also analyzes the policies and strategies with respect to the payment of salaries and benefits, incentive compensation, and succession planning, which includes the appointment, training and monitoring of senior management.

The *Conduct Review Committee* ensures that policies and procedures are in place to deal with related party transactions, conflicts of interest, and disclosure of identity to customers as it relates to third-party transactions.

The *Governance Committee* oversees the corporate governance system of Surrey Metro Savings. The committee ensures that the mission and strategic direction of Surrey Metro Savings is reviewed annually and that the Board and its committees carry out their functions in accordance with due process. In addition, this committee assesses the effectiveness of the Board and

its committees, and the contributions of each individual director. The committee has the responsibility to address governance issues, and to identify, recruit, nominate, endorse, recommend appointment of, and ensure orientation for new directors.

The *Investment and Loan Committee* is mandated to ensure that the Company adheres to prudent standards in making investment and lending decisions, in giving guarantees and committing the Company to other financial obligations, in writing down the value of investments and loans on its books, and in managing its investments and loans, including its subsidiary companies.

Relationship with and Expectations of Management

The Board has delegated to the CEO and senior management the responsibility for day-to-day management of the business of Surrey Metro Savings. Matters of policy and issues outside the normal course of business are brought before the Board for their review and approval, along with all matters dictated by statute and legislation. The CEO and senior management team review the Company's progress at Board meetings, which are held at least six times a year. Financial, operational, and strategic issues facing the Company are reviewed, monitored and approved at the Board meetings.

Recruitment of New Directors and Assessment of Board Performance

The Governance Committee of the Board is responsible for assessing the effectiveness of the Board as a whole, and the contribution of each individual director. The committee identifies, recruits, nominates, endorses, recommends appointment of (where applicable) and ensures orientation of new directors. The Governance Committee annually develops criteria which reflect the needs of the Board in recruiting new directors. The committee meets with, interviews and evaluates potential candidates to ensure that the Board is constituted with individuals of diverse background talents and experience and to ensure that when a vacancy occurs, qualified candidates are available.

Shareholder Feedback and Concern

The Senior Vice President, Finance, oversees an investor and shareholder relations program. The program involves providing information with respect to reported financial results and other announcements by the Company to a broad spectrum of investors and other stakeholders. Shareholder concerns of a significant nature are directed to the Senior Vice President, Finance and the CEO, for information and resolve, and management reports to the Board on these matters and other major shareholder and investor matters.

Board of Directors

Committee membership indicated by numbers following names

H.A. (Bert) Miles^{1,2,3}
Chairman
General Manager
Burnaby Lake Greenhouse Group

Bruce H. Chapman^{1,4,6}
Senior Vice Chairman
President
Aerofund, Inc.

Frank L. Harper^{1,2,5}
Vice Chairman
President
ThrillTime Entertainment International, Inc.

Lloyd M. Craig
President and Chief Executive Officer
Surrey Metro Savings

Tom R. Kirstein^{4,6}
Chartered Accountant
Kirstein, Neidig and Vance

Douglas T. Stone³
Director of Operations
City of White Rock

Rodney C. Bergen^{4,5}
Managing Director
Tax and Financial Analysis
Jim Pattison Industries Ltd.

Michael A. McCartney^{5,6}
Partner
Bouchard and Co.

J. Amber Goddyn^{2,3}
Notary Public

Committees of the Board of Directors

- 1 Executive
- 2 Governance
- 3 Human Resources
- 4 Conduct Review
- 5 Investment and Loan
- 6 Audit

Executive Officers

Lloyd M. Craig
President and Chief Executive Officer

Hermann G. Bessert
Senior Vice President, Finance

Robert H. Caldwell
Senior Vice President, Operations

J. Patrick Hagan
Vice President, Information Systems

Kenneth G. Hahn
Vice President, Human Resources

Rodney A. Marr
Vice President, Credit

James E. Miller
Vice President, Marketing

Administration Office

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Corporate Secretary

Cyndie Kremyr
Manager, Corporate Administration
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Registrar and Transfer Information

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Vancouver, BC V6C 3B9

Auditors

Grant Thornton
Suite 400, 604 Columbia Street
New Westminster, BC V3M 1A6

Stock Exchange Listing

Toronto Stock Exchange (TSE)
Symbol: SMS

Annual Meeting

The 52nd Annual Meeting will be held on Wednesday, May 5, 1999 at 7:00 p.m. at Newlands Golf and Country Club 21025 – 48 Avenue Langley, BC, Canada

Dividend

Surrey Metro Savings' current policy is to declare semiannual dividends for its Non-Voting Shares payable on December 1 and June 1 to shareholders of record on November 1 and May 1.

**Surrey Metro Savings
Credit Union**

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